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Orizzontecina

**The year 1992:
a turning point in China's "reform and open door policy"**

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As we celebrate the 40th anniversary of "the reform and open door policy" launched in China in December 1978, another crucial date is very often overlooked. Indeed, the period following Deng Xiaoping's trip to southern China in 1992 marks a break almost as deep as 1978 in the country's recent economic history. Because it was at this date that economic socialism ended and capitalism settled in China and not in 1978. Of course, it is arbitrary to date precisely such a complex process. The work of historians and economists working on the emergence of capitalism in Europe or the United States in the nineteenth century¹ or closer to us, in developing countries², has made it very clear that this is a very slow, complex and irregular process both in its pace of development and in the geographical areas affected by its mode of operation.

Yet, in hindsight, the importance of certain political choices taken during the period from Deng Xiaoping's trip to southern China at the end of 1991 to the 14th Congress of the Chinese Communist Party (CCP) in October 1992 have been crucial in putting in place the most important pieces of the "puzzle" for the emergence of capitalism.

¹ Jean Baechler, *Le Capitalisme*, Paris, Gallimard, 1995, 889 pp. ; Fernand Braudel, *Civilisation matérielle, économie et capitalisme, Xve-Xviiiè Siècle*, Paris, Armand Colin, 1979, trois volumes ; Eric Hobsbawm, *The Age of Capital*, London, Vintage Books, 1975, 354 pp. ; Kenneth Pomeranz, *The Making of a Hinterland State, Society, and Economy in Inland North China, 1853-1937*, Berkeley, University of California Press, 1993, 336 pp.

² Jonathan Zeitlin, "Les voies multiples de l'industrialisation", in *Le mouvement social*, n° 133, 1985 ; Douglas C. North, and R. P. Thomas, *The Rise of the Western World*, Cambridge, Cambridge University Press, 1973 ; Albert O. Hirschman, 1967, *Development Projects Observed*, Washington D.C., The Brookings Institution, 197 pp.

On the economic front, the choices of Chinese leaders were still reversible until 1991. The Planning system still played a central role in the urban economy. The entire state organization was still modeled on the Soviet model with so-called "industrial" ministries, an all-powerful State Planning Commission, a single-bank financial system, and an employment system and social protection centered on the state enterprise still called at that time "work unit" (*Danwei* in Chinese). It is impossible to rewrite history, but it would have been possible for Chinese leaders until 1991 to follow the Hungarian example before the collapse of the Berlin Wall³. The leaders would have ensured that the market retains a minor place in the mode of regulation of commercial transactions, investments and production. It is this question of the irreversibility of market processes that has remained at the center of debate between reformers and hardliners leaders throughout the 1980s. Barry Naughton in his book on China's economic reforms of the 1980s⁴, showed how the reformers have progressively won the battle by maintaining the level of production, sales, raw material supply and investment financing under the Plan at constant levels. Businesses were then encouraged to produce more because they kept a large part of the profits from non-Plan sales that operated under market mechanisms⁵. Chinese leaders could have followed the Hungarian example by raising the Plan's quota share as production increased, which would have kept the market share at a constant level. On the contrary, during the three years preceding the student movement of 1989, the reformers maintain at a constant level the share of the Plan, causing a rapid rise in the market. But in 1989, the hardliners who won the upper-hand against the reformers during the political crisis of Tiananmen student movement, decided to stop the progress of the reform and to reestablished the Planning system predominance. The collapse of the Soviet system and communism in 1991 will change the course the economic policy in China forcing the hardliners to compromise with Deng Xiaoping.

The major political decisions of the 14th Congress of the Chinese Communist Party in 1992, a result of a compromise between reformers and hardliners, will influence the establishment of a new regime of economic growth and a particular capitalist system that still continue today to govern the functioning of the Chinese economy: giving up the Soviet planning

³ Reforms program called "New economy" and launched in 1968, see Xavier Richet et Janos Kornai, *La Voie Hongroise*, Paris, Calman-Levy, 1986.

⁴ Barry Naughton, *Growing out of the Plan Chinese Economic Reform 1978-1993*, Cambridge, Cambridge University Press, 1995, 379 pp.

⁵ This so-called "double-track" system (Plan and Market) has led to many corrupt practices, companies being strongly encouraged in such a system to obtain raw materials covered by the Plan, and thus at subsidized prices, to sell their products on the market and reap the benefits remaining in the coffers of the companies.

system, continuing the control of the CCP and the state over the country's largest enterprises and the possibility of privatizing small and medium-sized state enterprises⁶, the recentralisation of the tax system, and the deregulation of the labor market, and more specifically the dismantling of the so-called "iron rice bowl" system that governed the labor system in industrial enterprises in urban areas. The abandonment of Soviet planning will sound the death knell of economic socialism and pave the way for major reforms such as the reform of the state sector, the establishment of institutions essential to the functioning of a market economy (taxation financial system, legal reforms). The 1994 tax reform will clarify the fiscal powers (resources and expenditures) between Beijing and the provinces, and rebalance tax revenues to the central government at the expense of the lower echelons of the administration. The deregulation of the urban labor market, the dismantling of the system of the "iron rice bowl" (employment for life, free housing and free social protection provided by State companies) and the lifting of the ban on recruiting labor force from rural areas, will lead to a lasting change in the balance of power between employees and employers. The latter will find themselves in a strong position in wage setting and in the sharing of labor productivity gains (which will be important throughout the decade). Businesses will be the big beneficiaries of this unequal sharing of productivity gains. State enterprises that will survive the major restructuring of the 1990s and the fast emerging private companies, will be able to significantly increase their cash flow and modernize themselves by investing massively in new production capacities. At the macroeconomic level, this resulted in the emergence in the late 1990s of a new growth regime based more and more on investment at the expense of consumption⁷. The dismantling of the "iron rice bowl" system will pave the way for the privatization of the urban housing stock in 1998 and a massive transfer of state ownership to households. They become overnight owners of their homes at prices much lower than those of the market. This privatization of housing will largely be at the origin of the boom of the real estate sector in the late 1990s with the possibility for households to resale at market prices of the old state enterprise housing or their rehabilitation.

Faced with the magnitude of the task, many at the time predicted a difficult future for communist Party rule and emphasized an incompatibility between the nature of the regime and the pursuit of capitalist-driven economic reforms. Nevertheless, the Chinese economy has been completely transformed during the decade 1992 - 2002 corresponding to the leadership of Jiang

⁶ See the slogan in the 1990 's: "Grasp the big and release the small"

⁷ The relative share of consumption on GDP will increase from 51% in 1992 to 36% in 2006 while the relative share of investment in GDP will increase from 34% in 1996 to 46% in 2010.

Zemin and Zhu Rongji. Socialism has almost disappeared in the economic system, and capitalism with its institutions and its share of inequalities has firmly anchored in China. A large domestic market has emerged, significant resources have been invested in education, and in major infrastructure programs and research and development. The advent of capitalism and economic take-off will have characterized this period, which will certainly appear, with the decline of history, as a crucial moment in the modernization of the country and in its economic history.

The major reforms and transformations of the Chinese economy resulting from the 14th congress of the CCP in 1992 will also produce their own dysfunctions inherited by Xi Jinping when he came to power in 2012. Already visible and identified by the Chinese government as early as 2004-05, these dysfunctions have been largely masked by the big economic stimulus plan launched at the end of 2008 to counteract the effects of the international financial crisis. Only when the effects of the stimulus plan run out of steam at the end of 2011, that these dysfunctions return to the front of the stage with even greater intensity⁸. The growth regime was too dependent on investments. Incomes and domestic consumption were growing at a slower pace than investments. Domestic income distributed to households was not sufficient to absorb domestic production. This prompted Chinese companies in 2003, in heavy industry in particular, to increase their exports causing more and more trade tensions with the United States and Europe (given the broken prices, often on the verge of dumping practices). The dependence of the economy on real estate and infrastructure led to a hypertrophy of heavy industry at comparable per capita income level. This hypertrophy of heavy industry, based on an energy model mainly dependent on coal, has also led to an unprecedented environmental crisis in economic history. The dismantling of the 'iron rice bowl' system has also weakened all social protection (pensions, and health insurance) in urban areas. Relegated last in the order of priorities of the reforms during the decade 1992-2002, social protection remained largely insufficient for households to decide to reduce their savings rate. More generally, the inadequacy of social redistribution, the lack of freedom of association for labor unions and counter-powers to CCP's control over the country's economy, have provided a fertile ground for the explosion of income inequalities. Finally, the state's control over the largest companies in the country decided in 1992 has continued and even strengthened in recent years, to the point of slowing the growth of the private sector in the national economy.

⁸ Georges Magnus, *Red Flags, Why Xi's China is in Jeopardy*, New Haven, Yale University Press, 2018, 226 pp.

These dysfunctions stemming from the political choices of 1992, in parallel with the rapid demographic evolutions (accelerated aging of the population), were all big challenges posed to Xi Jinping when he took the leadership of the CCP in 2012. The announcement of a vast plan of economic reforms during the 3rd Plenum of the CCP's 18th Congress in 2013 aimed at providing answers to these dysfunctions, foreshadowed the start of a new reform cycle comparable to 1992. Nevertheless, at the end of Xi Jinping's first term in 2017, most announced reforms remained dead letters or were very difficult to put in place. These reforms had strong political implications for the CCP (privatization of the state sector, reforms and opening of the financial system, tax reform of local governments) that would have resulted in a loss of control of the country's financial resources. Other reforms, such as the fight against environmental degradation, collided despite strong political will, with structural evolution (demographic, urbanization, rising living standards) and powerful lobbies from major industrial sectors who had been at the heart of Chinese growth since 1992 (energy, coal, heavy industry). Deng Xiaoping's economic legacy and the results of the 1992 compromise are still far to be overtaken by a new economic system.